

In the  
UNITED STATES COURT OF APPEALS  
For the Ninth Circuit

SADIE KATZ,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

BRIEF OF AMICUS CURIAE ON BEHALF  
OF CALIFORNIA BANKERS ASSOCIATION  
IN SUPPORT OF APPELLANT, SADIE KATZ

Clarence E. Musto  
Franklin C. Latcham  
Richard S. Kinyon  
Morrison, Foerster, Holloway,  
Clinton & Clark  
Eleventh Floor  
120 Montgomery Street  
San Francisco, California 94104

Attorneys for ~~Appellant~~ Amicus Curiae

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BRIEF OF AMICUS CURIAE ON BEHALF OF  
CALIFORNIA BANKERS ASSOCIATION IN  
SUPPORT OF APPELLANT, SADIE KATZ

TO THE HONORABLE JUDGES OF THE COURT OF APPEALS FOR THE  
NINTH CIRCUIT:

This brief is filed by California Bankers Association as amicus curiae, by their attorneys, Morrison, Foerster, Holloway, Clinton & Clark, in support of appellant Sadie Katz, pursuant to written consent of both the appellant and the appellee, filed herewith.



## INTEREST OF CALIFORNIA BANKERS ASSOCIATION

California Bankers Association is a trade organization composed of all 193 banks and trust companies in the State of California. Members of the association are actively engaged in serving as trustees under inter vivos trusts created with community property by California residents for the benefit of themselves and their families. Revocable inter vivos trusts are becoming increasingly popular in estate planning, both because of the continuity of management provided during and after the settlors' lifetimes and because the necessity of probate may be reduced or eliminated.

Normally, where a trust is established with community property, the settlors (the husband acting for his wife and himself as manager and controller of the community, or the husband and wife acting together) have no intention of changing the nature of their property from community to something else during the period in which the trust is revocable, although they may well intend to change their respective rights in the community when the trust becomes irrevocable upon the death of one of the spouses, or in some other manner. California Bankers Association as amicus curiae submits that this represents the general intention of the vast majority of California settlors of revocable inter vivos trusts created with community property.



Because of the large number of inter vivos, community property trusts now being administered by member banks in California Bankers Association and the advantages not only to the banks but to the public at large to be obtained from the creation and continued administration of such trusts, the holding of the district court in this case invokes great cause for concern. To construe a document such as the Katz Declaration of Trust (the Katz trust) in a manner that is so adverse to the normal desires and expectancies of the trustors of such a trust, is both patently unwarranted and patently a source of confusion in the taxation of community property interests.

#### STATEMENT OF THE CASE

The parties agreed, for purposes of defendant's motion for summary judgment, and the lower court found that the real and personal property placed in the Katz trust was "new" or post-1927 community property. See Finding No. 10 and Conclusion No. 5 (Record pp. 238-40). The trust was established by "LEROY JOSEPH KATZ, a married man," with the written approval of his wife, Sadie Katz. Although the trust instrument named Leroy Katz as the Trustor, the instrument is equivocal in that Article III on page one refers to both Leroy and Sadie as trustors (Record p. 63). "During the lifetime and competency of the Trustor, the Trustee" (Title Insurance and Trust Company) was to "have no rights, duties, or powers with respect to any property held under this Trust, it being



understood that the Trustor retains all such rights, and shall collect, receive, and disburse, without accounting to the Trustee or any other person, all income of every nature and description from the real and personal property held hereunder." Section Four, page 2, of the trust instrument (Record p. 64). Furthermore, the Trustor reserved the right "to revoke, terminate or amend" the trust at any time. Section Thirteen, page 7 of the trust instrument (Record p. 69).

Upon the death of the Trustor, management of the trust was to vest in Sadie Katz during her lifetime and competency, and she was to receive at least 80% of the income for her lifetime and additional amounts of the corpus if necessary for her reasonable support or in the event of her accident, illness, or other misfortune. The remainder of the trust estate was to be held for the benefit of and eventually distributed to Leroy and Sadie's issue. Sections Five through Twelve, pages 3-6 of the trust instrument and Amendments One and Three (Record pp. 79-86).

Prior to Leroy Katz' death the trust was amended on two different occasions. Both amendments were approved in writing by Sadie Katz under a heading entitled "Consent of Trustor's Wife to Partial Amendment" (Record pp. 83 and 86). Other than the two amendments



mentioned above, the trust remained unchanged and was in force on the date of Leroy Katz' death.

#### ISSUE

The issue presented by this case is whether, by virtue of the execution of the trust agreement, the entire property transferred to the trust became the separate property of Leroy Katz and is thus includable in full in his taxable estate, or whether the trust was a community asset until the time of Leroy Katz' death, so that only one half of the value of the trust property is includable in his gross estate.

#### ARGUMENT

##### I. The Issue in This Case Has Already Been Decided by This Court in Favor of the Taxpayer.

In the case of United States v. Stewart, 270 F.2d 894, rehearing denied per curiam (9th Cir. 1959), this court was faced with the precise issue that is involved in the present case, although in the context of annuity and insurance policies rather than a revocable inter vivos trust. The underlying principles with regard to all three types of property are identical. Accordingly, this court must overrule the District Court in the present case or repudiate its Stewart decision.

In Stewart the husband and wife were longtime California residents. The wife died in 1951 and the



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In Stewart the husband and wife were longtime California residents. The wife died in 1951 and the



husband survived her. At the time of the wife's death, there were in force 26 annuity and life insurance policies taken out by the husband on his life and paid for with community property funds. In determining whether one half of the cash value of these policies was properly includable in the wife's gross estate, this court had to answer three questions: (1) Were the policies community property under California law at the time of the wife's death? (2) If so, what was the nature and extent of her interests in these policies under California law? (3) Was the value of her interests includable in her gross estate? It is manifest that in Katz this court must answer these same three questions with regard to the trust, but their answers will be, because the husband died first, <sup>1/</sup> the converse of those in the Stewart case.

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1/ The analogous relationship between the two situations is shown even more clearly in Commissioner v. The Chase Manhattan Bank, 259 F.2d 231 (5th Cir. 1958), cert. denied, 359 U.S. 913 (1959), a case involving the taxation of insurance and inter vivos trusts established by the husband where he died first. The Chase Manhattan case is discussed later in this brief. It should also be noted that the court in both Stewart and Chase Manhattan properly distinguished between rights in the policy itself and rights in the proceeds of the policy, which is analogous to the distinction between the rights of the settlors under an inter vivos trust while it is subject to revocation and amendment, and the rights of the beneficiaries after the trust has become irrevocable and no longer subject to amendment.



A. The Annuity and Insurance Policies Involved in the Stewart Case Were Held To Be Community Property.

This court held that "Under California law, where policies are taken upon the husband's life during coverture and premiums are paid from community funds, the policies are community property. \* \* \* We find nothing in California law which indicates that life policies as items of community property are treated by rules other than or different from those <sup>or</sup> pertaining to community property generally." 270 F.2d at 897-98. This court found this to be true even though these policies were taken out in the husband's name and he alone possessed all the incidents of ownership.

B. Mrs. Stewart Shared a "Present, Existing and Equal" Interest With Her Husband in the Policies.

This court pointed out that

\* \* \* The respective interests of the husband and wife in community property "are present, existing and equal interests \* \* \*." Cal.

Civ. Code § 161(a). The husband retains possession and control of the community property. Cal. Civ. Code § 172. "Upon the death of either husband or wife, one-half of the community property belongs to the surviving spouse, the other half is subject to the



testamentary disposition of the decedent and, in the absence thereof, goes to the surviving spouse \* \* \*." Cal. Prob. Code § 201. 270 F.2d at 898.

C. One Half of the Cash Surrender Value of All The Annuity and Insurance Policies Were Included in Mrs. Stewart's Gross Estate.

This court held that "since all premiums were paid with community funds," all the policies were community property

\* \* \* unless the wife subsequently released her interest, converting it into separate property of the husband. The determination of the question of taxability depends upon whether the wife so released her interest. Whether the wife released her interest depends not alone upon whether she consented to the designation of beneficiaries, but also upon the incidents of ownership retained by the insured in the respective policies.

Ibid.

With regard to the husband's right to cancel the policy, this court stated that "if the husband took the cash surrender value before the wife's death, it would



remain community property in which she had a one-half interest"; and quoting with approval from California Trust Co. v. Riddell, 136 F. Supp. 7, 9 (S.D. Cal. 1955), this court determined that "The fact that the policies in question were retained by the husband and that he had a right to change beneficiaries at will does not mean he could deprive the wife of her community interest therein without her consent." 270 F.2d at 898-99.

1. The Annuity Policies.

This court found that one half of the value of all six annuity policies, which fell into three broad categories, was includable in the wife's gross estate for the reasons set forth below.

First Category - one policy. Four annuity policies had matured at the time of the wife's death and pursuant to the settlement agreements the value of each policy was to be paid in a fixed number of equal monthly installments, first to the husband, then the wife, and then to others. As to one of these annuity contracts, the wife had consented to the settlement agreement that was in effect at her death. This court viewed the wife's consent as follows:

In effect the joinder of the husband and wife in this settlement agreement constituted a transfer by the community under



which the community retained for its life, or the life of the survivor, the right to income from the property. In our opinion, this policy is includable under [the predecessor of Section 2036(a)(1) of the Internal Revenue Code of 1954] \* \* \*.

In any event, the wife's endorsement did not in our opinion constitute a surrender of her interest in the policy. Such a holding would mean that the payments coming to the husband under this contract would be his separate property rather than community property. We cannot presume that the wife <sup>2/</sup> so intended. Nor does the Ettlinger case compel a contrary conclusion. It is one thing to hold that a wife's consent to a beneficiary designation on an insurance policy on the husband's life means that she gave up her interest in the proceeds of the policy after

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2/ In Ettlinger v. Connecticut Gen. Life Ins. Co., 175 F.2d 870 (9th Cir. 1949), this court held that under California law a wife surrendered her community property interests in the proceeds of a policy on her husband's life by endorsing her consent to the designation of a beneficiary other than herself.



her husband's death. It is quite another thing to say that the husband and wife are making a gift of their community interests in an annuity contract when they join in a settlement agreement which has the effect of insuring that the community, or the survivor thereof, will receive the annuity payments as long as either is alive.

270 F.2d at 902.

Second Category - three policies. With respect to the other three matured annuity policies, the wife had consented to earlier settlement agreements, but they were revoked by the husband prior to her death and replaced by settlement agreements to which she did not consent. This court noted that "These transactions illustrate how illusory the wife's interest in the policies would be if it were held that by consenting to a revocable designation of beneficiaries, she surrendered her interest in the community property." Accordingly, this court held that the wife's one-half interest in these three policies was includable in her gross estate. Id. at 901.

Third Category - two policies. With respect to the two unmatured annuity policies, that were not endorsed by the wife, the husband had relinquished the right to obtain the value in cash. However, he retained the right to change



beneficiaries and the right to alter the mode of settlement by electing to have the policy mature at an earlier date. This court held that the policies remained a valuable asset of the community and one half of their value was includable in the wife's gross estate. Ibid.

## 2. The Insurance Policies.

This court also held that one half of the value of all twenty life insurance policies, which were divided into two general categories, was includable in the wife's gross estate.

First Category. On thirteen of these insurance policies that he took out on his life, the husband retained the right to change beneficiaries, but the wife had endorsed the designation of beneficiaries or mode of settlement. This court pointed out that although such an endorsement might result in a surrender by the wife of her community interest in proceeds after the death of her husband,<sup>3/</sup>

Here we are concerned with the rights in the policies themselves during the existence of the community. It is important to recognize this distinction in determining what rights were retained by the wife in

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3/ See Note 1, supra, p.6



the community assets. \* \* \* [Citation to Commissioner v. The Chase Manhattan Bank, supra, note 1.] Under California law the husband has the management and control over insurance policies on his life, although he cannot give them away without the written consent of his wife. Cal. Civ. Code § 172. In the event that the husband dies before the wife, she has the right to object to the proceeds of the policies going to a third person to the extent of her one-half interest therein. \* \* \*

\* \* \* It may well be true that had the husband predeceased the wife in the instant case, her consent to the designation of the beneficiaries would have precluded her from contesting such designation after the death of her husband, but such a rule should not be extended to the present situation. Where the husband retains both the right to obtain the cash value and the right to change beneficiaries, the wife cannot be held to have intended by her endorsement to surrender her community interest in the policies.



\* \* \* [T]he wife's endorsement of the designation of beneficiaries was at most an assent to an incompletely gift, which was still incompletely at the time of her death. It was not a transfer to her husband. We hold therefore that the wife's interest in these 13 policies is includable in the wife's gross estate for tax purposes.

Id. at 900-01.

Second Category. In the remaining seven life insurance policies, the husband retained the right to change the beneficiaries and to obtain the cash value, and the wife had not consented to the beneficiary designation. The wife's community one-half interest in these seven policies was held to be clearly includable in the wife's gross estate.

In concluding its discussion in respect to both the annuity and life insurance policies, this court held that the wife shared with her husband "present, existing and equal interests" at the time of her death, "that these interests amounted to ownership of one-half of whatever value the policies had at the time of her death, and that such an amount must be includable in her gross estate."

Id. at 902. "This is a logical result, since it is clear that upon the death of a husband, with a wife surviving,



only one-half of the proceeds of his life insurance, purchased with community funds, is includable in his estate. [Citing Lang v. Commissioner, 304 U.S. 264 (1938)]." 270 F.2d at 902, n.15.

II. The Fifth Circuit's Decision in Commissioner v. The Chase Manhattan Bank Also Requires a Decision in Favor of the Taxpayer in Katz.

The Court of Appeals for the Fifth Circuit, in Commissioner v. The Chase Manhattan Bank, 259 F.2d 231 (5th Cir. 1958), cert. denied, 359 U.S. 913 (1959), was faced with the question of "the gift tax effects of trusts and insurance in a community property state where the wife has a present, vested ownership of half the marital community in her own right." 259 F.2d at 234. The issues decided in this case are determinative of the issues in the Katz case because, as the Supreme Court determined in Estate of Sanford v. Commissioner, 308 U.S. 39, 44 (1939), "The gift tax was supplementary to the estate tax. The two are in pari materia and must be construed together." The Supreme Court reaffirmed this holding in Merrill v. Fahs, 324 U.S. 308, 311 (1945).

In Chase Manhattan the husband and wife were residents of Texas, a community property state, during their entire married life. In 1928 the husband created



two inter vivos trusts. One trust, the "insurance" trust, consisted of insurance policies on the husband's life, the premiums on which he paid with community funds. He reserved the right to modify or revoke the trust, and retained the right to change the beneficiaries of the policies. Upon the husband's death the insurance proceeds were payable to the trustee. Income was payable to the wife for life, with the remainder to the settlor's descendants. The other trust, the "living" trust, consisted of securities belonging to the community. Income was payable to the husband for life, then to the wife for life, with the remainder to the settlor's descendants. He reserved the right to modify or revoke the trust. The husband died in 1948.

The court pointed out that under Texas community property law, as in California, the husband acts as the managing agent or trustee of the community and can unilaterally sell community personal property. Unlike under California community property law, however, the Texas husband can also give away community property in its entirety without his wife's consent as long as it is not in fraud of her rights. See 259 F.2d at 239. Thus the unilateral, nonfraudulent designation by a Texas husband, of a third party beneficiary under a



"community" insurance policy or inter vivos trust has the same effect as a similar designation by a California husband with his wife's consent or approval.

A. The "Insurance" Trust.

The Commissioner contended that on the husband's death, the wife made a taxable gift of one half of the value of the proceeds of the insurance policies less the value of the life estate in that half. The taxpayer argued that although the husband could revoke the trust and change beneficiaries during his lifetime, the wife could not, and thus, as to her the trust was complete and irrevocable in 1928 when it was created.

The Fifth Circuit also recognized the difference between rights in the policy itself and rights in the proceeds of such policy, and after distinguishing these rights the court pointed out

\* \* \* that when Daniel took out the insurance and created the insurance trust, he acted and could act only as manager of the community.

The right of revocation was not in Daniel individually, nor was the trust irrevocable only as to Marie's half of the community.

Daniel held the power of revocation as agent



or manager of the community. When he died without having exercised that power, the insurance became payable and the trust became irrevocable. His death operated to effect a taxable transfer from the community (husband and wife) \* \* \*.

Id. at 246-47.

Up to the time of his death, Daniel, as managing agent of the community had the right to change beneficiaries. When he died without exercising this right, the transfer to the trustee was a completed gift from the community: one-half therefore should have fallen in the taxable estate of the deceased husband. The other half is a taxable gift from the surviving spouse.

Id. at 255.

B. The "Living" Trust.

The court noted that there was

\* \* \* no showing that the income from the \* \* \* living trust was handled any differently from Daniel's earnings and other income \* \* \*.

It must be borne in mind that Daniel did not create the trust. The community created it. Any rights that were reserved in the settlor



were rights held by the community. \* \* \*

Daniel's control \* \* \* could be exercised only as agent for the community.

Id. at 258. [Emphasis supplied by the court.]

In conclusion the court held:

Since Daniel retained the power of revocation (for the community), there was no taxable gift until the shift in beneficial enjoyment at his death. \* \* \* When Daniel died the trust became irrevocable. His community one-half should have been included in his gross estate under [the predecessors of sections 2036 and 2038 of the Internal Revenue Code of 1954], \* \* \* and Marie made a taxable gift of the other half \* \* \*.

Had Daniel been acting for himself instead of for the community, and had the right of revocation been retained by him individually the taxpayer would have been on stronger ground to urge that, as to Marie, the gift was complete in 1928. But it was as agent for the community, that Daniel held the right of revocation. For tax purposes the gift was incomplete until the right of



revocation ceased on Daniel's death.

Id. at 260-61.

III. The Board of Tax Appeals Has Decided a California Case, Very Similar to Katz, in Favor of the Taxpayer.

Bank of America Nat'l Trust & Sav. Ass'n, Ex'r (Estate of McGowan), 43 B.T.A. 695, acq., 1941-2 Cum. Bull. 2, nonacq., 1941-2 Cum. Bull. 15, appeal dismissed, 123 F.2d 64 (9th Cir. 1941), involved the estate tax consequences of a revocable inter vivos trust, created in part with post-1927 community property, in which the relevant facts were very similar to those in Katz. In 1929 the husband executed a trust instrument and conveyed two parcels of land to the trustees, one of which was his separate property. The other parcel had been purchased with the wife's separate property and a note, secured by a mortgage, which was eventually paid off with what the board treated as post-1927 community property. The husband reserved to himself the income for life, then the income was to go to the wife for life with the remainder to his issue. "He reserved the right to change or amend any of the trust provisions, to revoke the trust in whole or in part \* \* \*, and to withdraw 'any part or all of the trust estate.'" The



trust was to become irrevocable upon the settlor's death. "By an attached declaration his wife waived any 'community or other interests' which she might have in the real property transferred to the trust." 43 B.T.A. at 696-97. The trust property was leased by the husband personally in 1929, 1931 and 1932. At the end of each lease, the wife signed the statement: "I \* \* \* hereby consent to and join in the making of said lease \* \* \*." Id. at 697. In 1931 the husband and wife executed an agreement whereby all their property was to be considered community property.

The husband died in 1937, survived by his wife and seven children. The executor included only half of the value of the trust property in the decedent's estate. The Commissioner disallowed a community property exemption and included all of the trust property in the gross estate.

The Board of Tax Appeals held that the community property agreement was ineffective with regard to the trust property and therefore the value of the entire parcel that had been the husband's separate property was includable in his gross estate. As to the other parcel, however, the Board determined that 1/9 of the



purchase price had been paid with the wife's separate funds and the other 8/9 with post-1927 community funds. The Board then held that only 4/9 of the value of this parcel was includable in the husband's gross estate. The Board thus rejected the Government's argument that all of the trust property belonged to the husband, but held in effect that not only the community property but the wife's separate property as well retained its initial character and did not become the husband's separate property upon creation of the trust. The Commissioner expressed his nonacquiescence with this part of the Board's holding, but he nevertheless joined in a motion to dismiss the petitions for review by the Ninth Circuit.

IV. Application of the Law to the Facts Clearly Results in Only One Half of the Trust Corpus Being Includable in Leroy Katz' Gross Estate.

Leroy and Sadie Katz obviously intended to, and the above three cases demonstrate that they in fact did, establish with their community property a trust that was a community asset at least until the time of Leroy Katz' death, and thus only one half of the value of the trust property is includable in his gross estate.



A. Leroy and Sadie Katz Did Not Intend to Transmute Their Community Property Into Leroy's Separate Property, and Their Subsequent Actions Clearly Show That They Considered the Trust To Be a Community Asset.

It is submitted that an intention to transmute community property into the separate property of one of the spouses should not be found unless there is either a clear expression of that intent, or unless the advantages to be attained by such a transmutation clearly indicate the existence of such an intent. The basic safeguards built into the California community property system, especially for the wife's benefit, should be preserved unless a contrary intention is clearly evident.

The trust instrument itself made no specific mention that the property therein or the income therefrom was to be Leroy's separate property, and Sadie's written approval of the Declaration of Trust (Record p. 72) gives no indication that she intended to give Leroy her community interest in the property transferred to the trust. Furthermore, as shown hereafter, the deposition of Sadie Katz, taken November 17, 1965, clearly indicates that there was never any intention to convert the community property to the husband's separate property.



by conveying it to the trust.

It is inconceivable that Leroy and Sadie Katz could have intended to convert the property from community to Leroy's separate, since there appears to be no possible advantage to doing so and at least the following disadvantages. First, there could have been no reasonable tax planning motive for such a transmutation in the light of all of the facts in this case. Leroy had not only been sick long before the trust was created (Deposition p. 14), but he was two and one-half years older than Sadie. Accordingly, the chances clearly were that Sadie would outlive Leroy, and in fact a primary purpose in creating the trust was to provide for Sadie and their children after Leroy's death (Deposition p. 14). Thus, if a transmutation had been effected, the trust corpus available for the benefit of Sadie and the children after Leroy's death would have been depleted unnecessarily by an immediate gift tax at the time the trust was established as well as a greatly increased estate tax at Leroy's death. A second and more drastic disadvantage, at least to Sadie, of such a transmutation would be that Sadie, by giving up her community property rights, would have been left at Leroy's mercy, since the trust income would have been his separate property



and he could have amended or revoked the trust and effectively deprived her of any interest in the trust corpus whatsoever. It cannot be presumed that any wife would actually intend to give her husband such rights and powers.

The fact that Sadie's written consent was included on both amendments to the Declaration of Trust (Record pp. 83, 86) conclusively shows that Leroy, Sadie and the Trustee, all considered the trust to be community property. If they thought or intended that the trust property belonged to Leroy as his separate property, there would have been no need for Sadie's consent. Patently, the inclusion of her consent was inconsistent with such an intent and was actually an overt admission that the trust corpus was in fact not Leroy's separate property. As will be discussed in detail below, her consent was intended to have the same limited effect as the wife's consent to the change of beneficiary on a community insurance policy, i.e., to preclude her from contesting the validity of the amendments after the death of her husband.

B. The Terms of the Trust and the Manner of Its Creation Indicate That the Community Property Was Not Transmuted Into Leroy's Separate Property Upon Its Conveyance Into the Trust.



1. The Trust Remained a Community Asset  
of Leroy and Sadie Katz, Just As an  
Annuity or Insurance Policy Purchased  
With Community Funds Remains a Community  
Asset.

There is no reason why a revocable inter vivos trust established by the husband with community property should not be treated, for estate and gift tax purposes, the same as an annuity or insurance policy taken out by the husband on his own life and paid for with community funds. The analogy between the two would seem to be complete. Thus, the trust (or the rights thereto), like an annuity or insurance policy (or the rights thereto), is a community asset. Using language previously quoted from the Chase Manhattan case, when Leroy "created the \* \* \* trust, he acted and could act only as manager of the community." Leroy "did not create the trust. The community created it. Any rights that were reserved in the settlor were rights held by the community." Leroy's "control \* \* \* could be exercised only as agent for the community." 259 F.2d at 246, 258.

The fact that the income from the trust property was to be collected, received and disbursed by Leroy "without accounting to the trustee or any other person," and the fact that he reserved the right to revoke,



terminate or amend the trust, are not inconsistent with the conclusion that the trust was a community asset until Leroy's death. Under California law the community property is "under the management and control of the husband." Cal. Civ. Code § 161a.<sup>4/</sup> With regard to community personal property, he has management and control "with like absolute power of disposition, other than testamentary, as he has of his separate estate," although he cannot give it away or dispose of certain items without the written consent of the wife. Cal. Civ. Code § 172.<sup>5/</sup>

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4/ Cal. Civ. Code § 161a provides:

The respective interests of the husband and wife in community property during continuance of the marriage relation are present, existing and equal interests under the management and control of the husband as is provided in sections 172 and 172a of the Civil Code [quoted infra]. This section shall be construed as defining the respective interests and rights of husband and wife in the community property.

5/ Cal. Civ. Code § 172 provides:

Except as provided in section 172b [relating to the procedure for disposition of community property where one or both spouses are incompetent], the husband has the management and control of the community personal property, with like absolute power of disposition, other than testamentary, as he has of his separate estate; provided, however, that he cannot make a gift of such community personal property, or dispose of the same without a valuable consideration, or sell, convey, or encumber the furniture, furnishings, or fittings of the home, or the clothing or wearing apparel of the wife or minor children that is community, without the written consent of the wife.



His management and control of community real property is limited, but only to the extent that the wife must join with him in leasing such property for more than one year, or selling, conveying, or encumbering it. Cal. Civ. Code § 172a.<sup>6/</sup> Thus, the fact that Leroy Katz had "like absolute power of disposition" over the trust income is not at all inconsistent with a husband's normal statutory powers over community personal property. There was no showing that Leroy treated the trust income as his separate property, or any differently from the way he had treated the income from the property before the trust was created. Thus, Leroy should be considered to have received and held the trust income as community property, just as the annuity payments received by the husband in the Stewart case were treated as community property.

No California cases have been found that compel the husband to account to his wife for management of

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6/ Cal. Civ. Code § 172a provides:

Except as provided in Section 172b, the husband has the management and control of the community real property, but the wife, either personally or by duly authorized agent, must join with him in executing any instrument by which such community real property or any interest therein is leased for a longer period than one year, or is sold, conveyed, or encumbered \* \* \*.



community property during the continuance of the marriage. In fact the California Supreme Court has held that the husband's power of management and control of the community property is not terminated because he is also guardian of his incompetent wife, and continues "without the approval of or the requirement that he account to the court having jurisdiction of the guardianship matter." Schecter v. Superior Court, 49 Cal. 2d 3, 314 P.2d 10, 11 (1957). Apparently, it is only where the continuance of the marriage is threatened, such as in a divorce proceeding, or where the continuance of the marital community is threatened, such as when the parties are negotiating a property settlement agreement, that the husband must account to the wife for the community property. See, e.g., Flores v. Arroyo, 56 Cal. 2d 492, 364 P.2d 263 (1961); Vai v. Bank of America, 56 Cal. 2d 329, 364 P.2d 247 (1961); Jorgensen v. Jorgensen, 32 Cal. 2d 13, 193 P.2d 728 (1948).

Leroy's powers to revoke, terminate or amend the trust were not held by him individually but as agent or manager of the community, and the trust was not irrevocable as to Sadie's half of the community. An analogous conclusion was reached by this court and the Fifth Circuit in the Stewart and Chase Manhattan



cases, supra, with regard to the annuity and insurance policies and inter vivos trusts involved therein; thus a similar result in this case is supported by both reason and authority. Therefore, if Leroy had revoked the trust, he would have again held the property in his own name as agent or manager for the community, just as the cash received upon surrender of insurance policies is community property. And if he had amended the trust without Sadie's consent, the amendment would have been voidable by Sadie as to her community interest therein upon Leroy's death, just as the wife can claim her community half of insurance proceeds passing to a third party beneficiary not approved of by her. New York Life Ins. Co. v. Bank of Italy, 60 Cal. App. 602, 214 Pac. 61 (1923). The fact that Leroy retained these powers himself does not mean that he could have deprived Sadie of her community interest in the trust without her consent. To hold otherwise would mean that Leroy could have deprived Sadie of any interest in the property both before and after his death simply by amending the trust or revoking it and disposing of the property in such a manner as to defeat entirely her statutory interest therein. Such a result was not only clearly unintended by the husband and wife, but contrary to public



policy in that the basic safeguards built into California community property law to protect the interests of the wife could have been defeated inadvertently.

In a divorce or other proceeding in which Sadie's rights to the trust property might have been raised, it seems highly unlikely that any court would hold that she had no community property interest in the trust property. It has long been the law in California that when a husband gains an advantage in a transaction with his wife (which would surely have been true under the lower court's holding), there is a presumption of undue influence which will allow her to void the transaction. To overcome this presumption, the husband must show either that he made full and fair disclosure of "all that she should know for her benefit and protection," or that he dealt with her at arm's length and that she had independent counsel. Estate of Cover, 188 Cal. 133, 204 Pac. 583 (1922). There is no indication whatsoever in Sadie's deposition that she had any idea that she was giving up irrevocably her community interest in the trust property; and it is quite clear that she did not deal with Leroy at arm's length and



did not have independent counsel (Deposition pp. 12,14-15). Thus, under state law Sadie could have asserted a community interest in the trust if Leroy had dealt with the property as his own to Sadie's detriment. In the Stewart case this court recognized the long standing rule that the federal taxation of the husband and wife's interests in community property depends upon state law. 270 F.2d at 897. See also Greenwood v. Commissioner, 134 F.2d 915, 918 (9th Cir. 1943) (holding that the value of the gross estate for federal estate tax purposes is determined by looking to state law).

2. The Legal Effect of Sadie's Approval of the Trust and Consent to Its Amendments Is Identical to the Effect of the Wife's Approval of the Beneficiary Designations in Annuity and Insurance Policies.

Whether the wife releases her interest in an inter vivos trust, established by the husband with community property, by approving of its terms, depends upon the rights and powers retained by the husband in the trust, just as this court in Stewart determined that "whether the wife released her interest [in community life insurance policies purchased by the husband on



his life] depends not alone upon whether she consented to the designation of beneficiaries, but also upon the incidents of ownership retained by the insured in the respective policies." As pointed out above, where the husband has retained the right to the income for his life and the power to revoke, terminate, or amend, the wife has a community interest therein, subject to her testamentary power of disposition, just as a wife's interest in community annuity or life insurance policies passes by will or intestacy. It may well be true that by approving of the trust and consenting to the amendments thereto, Sadie was bound by the terms of the amended trust when it became irrevocable on Leroy's death, to the same limited extent as the wife in the Ettlinger case surrendered her community property interest in proceeds of an insurance policy on her husband's life by endorsing her consent to the designation of a beneficiary other than herself. The distinction between the wife's rights in a community trust before and after the husband's death is analogous to the distinction recognized by this court in Stewart between the rights in a community insurance policy and the rights to the proceeds. Where the husband retains any rights and powers in the trust, the wife cannot be held to have intended by her endorsement to surrender her community



interest in those rights and powers. Using language previously quoted from this court's Stewart opinion, her endorsement "was at most an assent to an incompletely gift \* \* \*. It was not a transfer to her husband." 270 F.2d at 901.

A further distinction can be drawn between the rights and powers retained in the trust, and the rights and powers with respect to the property transferred into the trust, i.e., the trust corpus. By approving of the trust, Sadie may have parted revocably with her community interest in the real and personal property transferred to the trustee, in exchange for her community interest in the rights and powers in the trust held by Leroy as agent for the community. Thus the rights and powers retained by Leroy in the trust were community assets; the trust corpus as such was not community property. It belonged to the trustee (legally) and beneficiaries (equitably), subject to divestment or change by the community.

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7/

The reservation of a power of revocation does not prevent the creation of a trust in the lifetime of the settlor, and the beneficiary at once acquires a future interest, although it is an interest subject to be divested by the exercise of the power. The death of the settlor is not a condition precedent to the vesting of the interest in the beneficiary.

1 Scott, Trusts § 57.1 at 447 (2d ed. 1956).



This distinction apparently is what the court meant in Kirkwood v. Bank of America, 43 Cal. 2d 333, 273 P.2d 532 (1954), an inheritance tax case dealing with a revocable inter vivos trust created by the husband with pre-1927 community property, where it said,

\* \* \* The husband was the transferor with the wife's consent. \* \* \*

At the time of the transfer she had the power of restraint \* \* \* but instead of exercising it by withholding her signature \* \* \*, she with the advice of counsel, signed a formal consent to "all of the terms and conditions" of the "Trust Agreement." She thereby parted voluntarily with her expectant statutory rights in the community property as they existed before the transfer, and she succeeded to a new and different interest in the property subject to the trust upon giving her consent to the inter vivos disposition breaking up the community status of the property transferred.

Id. at 339-40, 273 P.2d at 535.



In any event Kirkwood is not actually in point since there:

(a) the trust had been established with pre-1927 community property, in which the wife had only an expectancy and not present ownership in her one half of the property; and

(b) the court was applying an inheritance or succession tax, whereas the federal estate tax is a transfer tax. See Lowndes & Kramer, Estate and Gift Taxes 2-3 (1962).

C. Estate and Gift Tax Consequences of the Katz Trust Pursuant to the Above Analysis.

At the time the trust was created in 1956, there was an incomplete (revocable) transfer to the trust beneficiaries by both Leroy and Sadie, and thus there was no completed gift by either of them from which a gift tax could result. This is because their community real and personal property was simply exchanged for the community rights and powers relating to the trust, including the power of revocation, and thus nothing was irrevocably given up.

On Leroy's death in 1960 only half of the value of the trust property is properly includable in



8/ his gross estate. Under either section 2036(a)<sup>8/</sup>  
or 2038(a)(1)<sup>9/</sup> of the Code only one half of the

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8/ Section 2036(a) of the Internal Revenue Code of 1954 provides:

(a) General Rule. -- The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death --

(1) the possession or enjoyment of, or the right to the income from, the property, or

(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

9/ Section 2038(a)(1) of the Internal Revenue Code of 1954 provides:

(a) In General. -- The value of the gross estate shall include the value of all property --

(1) Transfers on or Before June 22, 1936 -- To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power



property could be included because he "transferred" only his community half of the property. The other half was transferred by Sadie. Although Leroy could revoke, terminate or amend the trust, only half of the trust property can be included in his gross estate under section <sup>10/</sup> 2041(a)(2), since unilaterally he could thereby

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(Continued)

(in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation or decedent's death.

<sup>10/</sup> Section 2041(a)(2) of the Internal Revenue Code of 1954 provides:

(a) In General. -- The value of the gross estate shall include the value of all property --

\* \* \* \*

(2) Powers Created After October 21, 1942. -- To the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, \* \* \*.

Section 2041(b)(1) provides:

(b) Definitions. -- For purposes of subsection (a) --



"appoint" only his half of the community to himself, his estate, or the creditors of either. The other half would still belong to Sadie and could be recovered by her. His rights over the trust property were certainly no greater than if he had held the property in his own name as agent or manager for the community, and this was recognized by Leroy and Sadie when her consents were required for amendments of the trust. Since only his community half of the property would have been included in his estate in the latter case, no more than half should be included in his estate because the property was in a revocable trust. This is consistent with the result in Lang v. Commissioner, 304 U.S. 264 (1938), where it was held that upon the death of a husband, with a wife surviving, only one half of the proceeds of insurance on his life, purchased with community funds, is includable in his estate.

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(Continued)

(1) General Power of Appointment. -- The term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate \* \* \*.



It seems clear that Sadie made a taxable transfer of her half of the trust property but not until Leroy's death. See the Chase Manhattan case, supra. By consenting to the trust and subsequent amendments, Sadie surrendered her community property interest in the "proceeds" of the trust as amended, to the extent of the other beneficiaries' interests therein. This transfer was incomplete until Leroy's death, since he, as agent and manager of the community, could have revoked the trust and returned the trust property to the community. On his death the trust became irrevocable, completing the transfer, and thus Sadie would appear to have become liable for a gift tax based on the difference, if any, between the value of her community half of the trust that she gave up and the value of her interest under the terms of the trust.

This same half of the trust property will also be includable in Sadie's gross estate on her later death under section 2036(a)(1), since she consented to a transfer of her half of the community property into the trust and retained for her life "the possession or enjoyment of, or the right to the income from, the property."

If Sadie had predeceased Leroy, one half



of the value of the trust would have been includable in her gross estate under section 2033,<sup>11/</sup> since the trust was a community asset, in which she would have had a community interest at her death. This follows upon authority of the Stewart case where one half of the value of the community annuity and insurance policies were includable in the wife's gross estate where she predeceased her husband.

#### CONCLUSION

There is no element of tax avoidance involved in this case. Under the theory of the tax-payer and the amicus curiae, half of the trust property is taxable to the husband on his death, and the other half will be taxed to the wife on her later death. In addition, the wife is liable for a gift tax as a result of the trust's becoming irrevocable at the husband's death. This is at least as much tax liability as if there had been no inter vivos trust, and the property had been put into a similar testamentary trust under the husband's will. Tax-payers in community property states should not be

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11/ Section 2033 of the Internal Revenue Code of 1954 provides: "The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death."



overtaxed because they chose to establish an orderly method of managing and passing on their community property before their deaths and to avoid the bother and expense of probate proceedings.

The district court's unrealistic opinion in this case has created a tax trap and threatens to disrupt the intention of the trustors of many trusts presently in existence. If the district court's analysis is correct, a great many existing trustors may already be retroactively trapped. Thus, if the lower court's decision is upheld, it necessarily follows that Sadie made a taxable gift to Leroy of her half of the community property passing into the trust at the time it was created, and either Sadie or the trust corpus necessarily would be subjected to an additional and substantial gift tax as well as Leroy's estate tax on the entire trust corpus. Finally, under the Government's theory, there is no guarantee that one half of the trust corpus would not be includable also in Sadie's gross estate under section 2036(a)(1) on her later death, because she consented to a transfer of her half of the community into a trust under which she was a life income beneficiary (after the prior



life estate of her husband).

The Government's position in this case not only lacks reason and authority but it seeks an inequitable result. If the lower court's decision is upheld, Leroy and Sadie Katz and their estates will end up paying considerably more tax than if the property had never been placed in trust. Thus, the Government is attempting to capitalize on a situation that in reality never existed, by reading the language of the trust literally but in vacuo and ignoring the realities of the community property system. We concur heartily with the Fifth Circuit in the Chase Manhattan case where it was said: "The Commissioner [of Internal Revenue] owes a duty to the United States government to litigate zealously in the interest of collecting taxes. But he owes a duty to all taxpayers, including the litigating taxpayer, to see that the tax law is applied justly." 259 F.2d at 237.

It is respectfully submitted that for the reasons given herein and in the brief filed by Appellant Sadie Katz, the judgment of the lower court should be reversed. If this court does not



reverse the lower court, it is manifest that the following undesirable results will pertain:

First, and foremost, the Estate of Leroy Katz will be excessively and unjustly taxed;

Second, numerous other estates will be harassed by revenue agents attempting to apply the Katz case to other community trusts; and

Third, a long series of court actions will be instituted by estates in attempts to obtain an overruling of the Katz case or at least to have its application be so circumscribed as to render it nugatory.

It is incumbent on this court to obviate all three of the above results here and now.

Dated: November 4 , 1966.

Respectfully submitted,

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Clarence E. Musto  
Clarence E. Musto

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Franklin C. Latcham  
Franklin C. Latcham

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Richard S. Kinyon  
Richard S. Kinyon

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Morrison, Foerster, Holloway,  
Clinton & Clark

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Morrison, Foerster, Holloway,  
Clinton & Clark

Attorneys for Appellant *ANNEUS GULDE*  
*Sadie Katz* *CALIFORNIA BANKERS ASSOCIAT*



I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

RICHARD S. KINYON

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Richard S. Kinyon  
for  
MORRISON, FOERSTER, HOLLOWAY,  
CLINTON & CLARK



CERTIFICATE OF SERVICE BY MAIL

RICHARD S. KINYON hereby certifies:

That his business address is 120 Montgomery Street, San Francisco, California 94104; that he is an active member of the State Bar of California and that he is not a party to the cause.

That on the date hereof he served three copies of BRIEF OF AMICUS CURIAE ON BEHALF OF CALIFORNIA BANKERS ASSOCIATION IN SUPPORT OF APPELLANT, SADIE KATZ on each of the following, by placing three copies of each of said documents in an envelope, addressed, respectively, as follows:

(1) BURTON S. LEVINSON, ESQ.  
Levinson, Marcus & Bratter  
8500 Wilshire Blvd., Suite 801  
Beverly Hills, California 90211

(2) MITCHELL ROGOVIN, ESQ.  
Assistant Attorney General  
U.S. Department of Justice  
Tax Division  
Washington, D.C. 20530

Attention:  
RICHARD C. PUGH  
Acting Assistant Attorney General

LEE A. JACKSON,  
Chief, Appellate Section

(3) UNITED STATES ATTORNEY  
c/o Loyal Keir, Chief, Tax Division  
600 United States Courthouse  
312 North Spring Street  
Los Angeles, California 90012



That said envelope was then sealed and postage fully prepaid thereon and on said date was deposited in the United States Mail (Registered) at San Francisco, California.

Dated: November 4, 1966.

RICHARD S. KINYON

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Richard S. Kinyon  
Attorney

